World Bank's Report on Lebanon "The Deliberate Depression": A Review

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This is a critical summary of the World Bank report (Lebanon Economic Monitor: The Deliberate Depression, Fall 2020). It assesses how Lebanon's economy can recover by applying reforms while taking into consideration the Lebanese economic scene in 2020 and 2021.

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Policy Context: Lebanon is facing an unprecedented economic and financial crisis. The instability of domestic politics has worsened the situation. In details, the formal government of "Hassan Diab" tried to regain macro-financial stability in Lebanon by establishing an economical plan that tackled important economic aspects, like exchange rate adjustment, comprehensive debt restructuring, and growth enhancing reforms. However, the plan has raised conflicts between the government and BDL concerning the calculation of debt losses in the financial sector, and banking sector restructuring. As a result, the negotiations between Lebanese authorities and the IMF have been stalled.

Macro-Financial Developments: Lebanon faced three main crises in 2019 and 2020, starting by the economic crisis in October 2019, followed by the worldwide pandemic Covid19, and ending by the huge blast at port of Beirut on the 4th August 2020. In fact, the real GDP is projected to decline by 19.2 percent in 2020, due to several factors. In details, tourist arrivals fell by 71.5 percent year-on year (yoy), over the first five months of 2020, due to the instability of political and economic situation in Lebanon since October 2019, and the worldwide pandemic Covid19. Further, the BLOM-PMI index, recorded an average of 40.4 over the first 9 months of 2020 (less than 50 represents a contraction of activity) compared to 46.8 for the first nine months of 2019. Meanwhile, the real estate sector has improved, as many depositors were trying to liberate their money from the banks by investing in real estate through banker checks (due to the informal capital controls imposed by banks since October 2019). However, construction permits and cement deliveries slumped by 60 percent and 52 percent, respectively, in H1 2020. On the other hands, consumption and investment are expected to contract sharply, with consumption historically constituting the most of output.

On fiscal side, tax and non-tax revenues are expected to decline, due to the contraction in economic activity, However, total expenditures have decreased in the first six months of 2020 by 16.2 percent, due to the default decision on Eurobonds taken by the government on March 2020. Further, GDP-debt ratio is expected to reach 194 percent at end of 2020, compared to 171 percent end-2019.

The financial sector witnessed a heavy deleveraging as total private sector deposits in commercial banks shrank by 10.2 percent in August 2020. The decline of customer deposits is due to several factors, as Lebanon became heavily cash based in LL. Furthermore, the commercial banks witnessed deterioration in their net foreign asset, and on their credit portfolio.

Concerning the exchange rate, the Lebanese lira has depreciated against the dollar and reached LL10,000/USD in 2020. The price of goods and services have surged in reflection of the high import component of the consumption basket. As result, merchandise imports slumped by 50 percent in the first 8 months of August 2020, and that drove a 59 percent decrease in the trade of good deficit. Overall, the World Bank expects a contraction of the current account deficit in 2020 to 14.4 percent of GDP, compared to a medium term (2013-108) average of 22.8 percent.

The financial crisis in Lebanon had a negative impact on the BDL FX reserves, as the sudden stop in capital inflows has implied a steady depletion of FX reserves at BDL. As of end September 2020, BDL's gross foreign asset position reached $25.9B, declined by $11.3B since end-2019.

Outlook and Risk: The World bank expects GDP to contract by a further 13.2 percent in 2021. Further, the poverty in Lebanon is likely to continue to worsen, surpassing half of the population by 2021. In details the decline in purchasing power is affecting most of the population, as Lebanese households will find it hard to meet essential needs such as food and access to healthcare services.

Lebanon needs to adopt a macro-financial stability strategy that should be based on debt restructuring, new monetary policy framework, and growth-enhancing reforms. However, this plan needs to be supported by international aid; and private investment will be mandatory for comprehensive recovery and reconstruction.

A Reform Agenda to Turn the Country Around: The reform agenda focuses on economic efficiency and restoration of trust. In details, it compromises five essential pillar that focus on macro stabilization and better governance and accountability.

1. Macroeconomic Stabilization: Lebanon needs to establish a new macroeconomic strategy that mainly focuses on exchange rate and monetary policy in order to control inflation and restore confidence between citizens and the government. Further, Lebanon should implement new laws and regulations regarding the BDL's balance sheet and adopt new policy actions on exchange rate and monetary policy framework. Furthermore, Lebanon needs to reduce debt to a sustainable level, by negotiating with creditors.

Restructuring the banking sector is essential in order to restore confidence with investors. Lebanese banks should recognize losses due to their large exposure to the sovereign and proceed with a restructuring plan. However, this step should be backed by legislative initiatives that are necessary to establish an effective bank resolution framework.

On the fiscal side, Lebanon will need to reduce it fiscal deficit by introducing new measures to increase direct and indirect taxes and raising VAT and rationalize expenditures. On the other hand, Lebanon has to improve the industrial and agricultural sectors, and have clear plan to increase exports by adopting a comprehensive investment strategy.

2. Governance and Accountability: Lebanon suffers from high corruption levels according to Transparency International's Corruption Perception index. Lebanon needs to fight corruption by establishing a well-governed public procurement system. In addition, the public financial management (PFM) and public Investment management (PIM) are weak and should be strengthened by improving transparency, accountability in managing public finances and investments. Meanwhile, government should achieve better debt management by applying reform steps that ensure debt sustainability.

3. Infrastructure Development: Lebanon lags in several basic areas: telecommunication, electricity, transportation, and water and sanitation. In fact, the private sector in Lebanon can play a major role by investing in the public sector through public private partnership (PPP). However, the private sector will need guarantees that should be provided by the government. Concerning the energy sector, the World bank outlined a solution that aims to apply the law 462 with subsequent amendments. In details, the law called for restructuring the sector by limiting Edl's role and transfer the system operations to private sector.

4. Economic Opportunities: Lebanon needs to attract new investment and find new source of growth. In details, the government should develop the financial sector by adopting a sector-wide digital transformation strategy. In fact, digital finance will reduce cost of financial transactions and improve the productivity and efficiency of businesses.
On the other hand, the government should encourage new entrepreneurs to enter the Lebanese market by improving investment policy and promotion.

5. Human Capital Development: A human capital development package is a must in order to exit the crisis. The reforms should tackle serval sectors like education, healthcare, environment and social sustainability and inclusion. Concerning education, the government should support the lowest performing schools in the short run, and improve the efficiency of public education financing, and develop a new national curriculum framework in the medium term.
For healthcare, the government should have a clear strategy to fight the Covid19 virus, by benefiting from the resources of private sector. Further, the government should extend health insurance coverage under the NSSF after unemployment.

6. Example of Reforms' Time-line: It is worth mentioning that the suggested reforms were defined by a clear timeline that took into consideration the steps required to execute in the short and long run. We will present some examples below regarding this timeline:

	2021	2022	2023	2025
Pillar 1: Macroecomic Stablization	Capital control law Policy actions on exchange rate	Stengten BDL's balance sheet		
Pillar 2: A Governance and Accountability Reform Package	Implement a Medium-term debt management strategy Design Finanacial Commitments and Contingent Liabilities Framework	Revise/ratify oublic debt management law	Establish independent debt management body	
Pillar 3: Infrastructure Development Reform Package	Privatization	PPP commitments	Wide use of PPP	
Pillar 4: An economic Opportunities Reform Package	Develop and adopt an investment strategy for retaining and attracting FDI or Non-Equity Modes of Finacing	Develop a proaactive investor outreach program Establish a one stop shop for investors at IDAL		
Pillat 5: Human Capital Development Reform Package	Support remote learning / Address and support the lowest performing school		Improve the relevance of higher education	Regulate the private sector for quality delivery of services

Macroeconomic Indicators for Lebanon; 2017–2021

`	2017	2018	2019	2020	2021
Real sector					
Real GDP	0.9	-1.9	-6.7	-19.2	-13.2
Real GDP per capita	-0.6	-2.5	-6.8	-19.6	-13.6
Agriculture(share of GDP)	4.5	4.4	5	4.7	4.7
Industry (share of GDP)	12.3	12	10.6	13.3	13.3
Services (share of GDP)	71.6	72.2	74.3	78.3	78
Net Indirect taxes (share of GDP)	11.6	11.4	10.1	3.7	4
Money and prices					
CPI inflation (p.a)	4.5	6.1	2.9	75	40
Money	4.2	3	-6.7	130	60
Investment & saving					
Gross capital formation	21.4	20.8	18.5	6.3	4.2
o/w private	19.9	19.1	17.2	5.2	2.4
Gross national savings	-1.5	-3.5	-2.7	-8.1	-3.7
o/w private	-4.8	-5.3	7.9	-3.4	-1
Central government finance					
Revenue (Including grants)	21.9	21	20.6	11.5	13.5
o/w tax revenues	15.5	15.4	15.5	7.8	8.8
Total expenditure and net lending	28.6	32	31.2	17.3	18.1
Current	27.1	30.3	29.9	16.2	16.2
o/w interest payment	9.4	9.8	10	2.3	2.4
Capital & net lending (excluding foreing financed)	1.5	1.7	1.3	1.2	1.9
Overall balance (deficit(-))	-6.7	-11	-10.5	-5.9	-4.6
Primary balance (deficit(-))	2.7	-1.2	-0.5	-3.6	-2.2
External sector					
Current account balance	-22.9	-24.4	-21.2	-14.4	-8
Trade balance	-24.7	-24.8	-24.9	-4.4	2.7
o/w exports (GNFS)	36	35.7	35.4	35	44.6
Export goods	7.6	7	9.3	13.9	17.5
Exports services	28.4	28.7	26.1	21.1	27.1
o/w imports (GNFS)	60.8	60.5	60.3	39.3	41.9
Imports of goods	34.7	34.4	35	22.7	24.2
Imports of services	26.1	26.1	25.2	16.6	17.7
Net private current transfers	2.3	2.5	5.6	-10.4	-11.2
Net remittances	5.2	4.2	6.1	10.1	14.1
Net income receipts	-0.5	-2.1	-1.9	0.4	0.5
Gross reserves (months of imports GNFS)	15.6	14.3	14.3	23.8	12.5
Total public debt					
Total debt stock (in million US$)	79,530	85,139	88,900	62,276	55,464
Debt-to-GDP ratio (percent)	149.7	154.9	171	194	211.7
Memorandum items					
GDP (in million US$)	53,141	54,961	51,992	32,103	26,200

Assessment of the Report: The report is comprehensive and thorough and covers all essential macro and reform aspects. It is also distinguished by a unique timeline that specifies the time framework for executing each and every reform. However, we believe that it missed four crucial considerations:

1. There is no discussion about the sequencing of reforms: should reforms start in the real sector in terms of regulations, governance and the business environment, followed by monetary and financial reforms, and then ended by fiscal reforms, as economic theory would predict; or should the reforms be sequenced differently, given the country's unique characteristics, and how?

2. The report shied away from apportioning the financial losses among the main financial players, especially since it has proven to be a contentious issue in past reform proposals. This is particularly true of bank deposits held at BDL and are now in excess of $80 billion.

3. It is not clear what these reforms will cost and who will fund them. As important, it is not clear how they will be implemented given the dearth of capable and well-governed capacities in the country, especially at the policy making and execution levels.

4. Lastly, the report's title is "Deliberate Depression", which seems to mean that the lack of policy action and reform efforts in the country is intentional. Although the action – or lack of it – pf Lebanese politicians and officials leave a lot to be desired, to say that the economic depression is intentional is perhaps misguided, given the deep domestic and regional entanglements that the country has itself into.

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